

USAID/Mongolia

Operational Plan

FY 2006

June 12, 2006

Please Note:

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Program Performance Summary FY 2005: BACKGROUND: In 1991, Mongolia shook off its dependence on the Soviet Union and embarked on far-reaching political and economic reforms. On the political front, Mongolia conducted a series of elections and peaceful changes of government and introduced a degree of political openness unheard of by previous generations. Simultaneously, Mongolia made significant steps toward establishing a market economy. The private sector, both formal and informal, now accounts for 75 percent of GDP--up from virtually nothing in 1991. The challenge over the next five years is to consolidate these still fragile changes and help Mongolia become an attractive place to invest money, do business, and create jobs. Mongolia's ability to reach this goal will hinge on its willingness to deal forthrightly with a series of "good governance" issues, including accountability, transparency, and corruption.

Roughly the size of Alaska, landlocked between Russia and China, and isolated for centuries, Mongolia is now opening itself to the world economy. Mongolia's southern border with China extends for 2,800 miles, China's single longest border with any country. Mongolia's northern border with Russia extends for 1,900 miles. From a political and economic standpoint, an independent, democratic, secure, and prosperous Mongolia will contribute greatly to stability in both Central Asia and Northeast Asia.

Per capita income in Mongolia is around \$650 a year. This figure does not fully capture the contributions made by Mongolia's increasingly vibrant "underground" economy, fueled by thousands of Mongolians who live and work in Asia, Europe, the United States and elsewhere. Mongolia's estimated GDP is \$1.6 billion, but a shadow economy survey in 2005 found that about half of GDP is hidden to avoid taxes. External debt is about \$1.4 billion, almost equal to GDP. Most debt is on concessionary terms, primarily from the Asian Development Bank (ADB), World Bank, South Korea, Japan, and China. After several years of stagnation, Mongolia's GDP growth reached 4.0 percent in 2002, 5.6 percent in 2003, and 10.6 percent in 2004. The recent growth in GDP is primarily attributable to increased mining activity (gold) and the recovery of livestock herds from losses incurred during harsh winters from 1999-2002. Growth in the mining sector was the principal contributor to the reduction in Mongolia's trade deficit.

The termination of the Multi-Fiber Agreement (MFA) in 2005 had a significant impact on Mongolia's textile industry. About 30 percent of foreign-owned firms in the sector left Mongolia or simply closed their operations here. Estimates indicate that in the first ten months of 2005, total manufacturing output fell by 26 percent compared to the same period in 2004, and textile and apparel output fell by 41.5 percent and 69 percent over the same period, respectively. (Data in fixed prices.) Exports of finished textile products declined by 40.5 percent. Data on the impact on employment is not yet available, but the loss of jobs in the textile industry may be as high as one-third of the labor force in that sector. The "shock" was dramatic, and only the significant gains in the mining sector kept national aggregate indicators from falling.

The performance of Mongolia's health and education indicators remains impressive, reflecting the large share of budgetary resources devoted to them. The percentage of those over 15 who can read and write is officially around 98 percent. In contrast to most developing countries, Mongolian women are more likely than men to graduate from high school. At the university level, more than two-thirds of all students are women. More than 95 percent of all Mongolian children are vaccinated; life expectancy is around 65 years, and infant mortality is estimated at 23 per 1,000. In these areas, Mongolia outperforms most other countries at a comparable stage of development.

A commitment to economic and political reform, an educated population, and an abundance of natural resources all combine to provide Mongolia with a unique opportunity to participate on the world stage. Yet much remains to be done. The reforms passed by Parliament not only need to be effectively implemented; they also must become part of a "living culture" that builds on the strengths of a market economy while adhering to the norms of a real democracy. In addition, Mongolia must continue to move aggressively to expand transparency, root out corruption, further reform the court system, and streamline commercial rules and regulations to encourage local entrepreneurs, attract foreign investment, and ensure a more just and democratic society for its citizens.

U.S. INTERESTS AND GOALS: An effective USAID program in Mongolia supports several U.S. foreign

policy interests:

-- First, a strong, secure, and prosperous Mongolia promotes stability in a potentially volatile region. A stable, independent, and democratic Mongolia contributes to overall stability and prosperity in the region. It is in U.S. national interests that Mongolia succeed.

-- Second, a successful Mongolia provides a potent example to other countries on how to launch effective political and economic reforms. This positive example extends to central Asia, as well as to a wide swath of East Asia including Vietnam, Laos, and perhaps eventually North Korea.

-- Third, Mongolia has become a reliable ally in the ongoing war on terrorism. The fifth rotation of Mongolian peace-keepers is currently in place in Iraq and a training unit is in Afghanistan.

The two USAID Strategic Objectives (SOs) in Mongolia, private sector-led economic growth and more effective and accountable governance, reinforce and build on each other. Their achievement will do much to ensure stability in Mongolia and beyond. USAID projects focus on policy reform, a streamlined business environment, more competitive industries, judicial reform, and strengthening the Parliament and are coordinated with the rest of the Country Team, including the Economic, Political, and Public Affairs sections. A robust U.S. Department of Agriculture (USDA) Section 416b wheat program further increases the level of U.S. resources for Mongolia, and selection of Mongolia as a potential recipient of resources from the Millennium Challenge Account (MCA) may increase that level dramatically.

DONOR RELATIONS: On a per capita basis, Mongolia ranks as one of the highest recipients of foreign assistance in the world. The ADB, the World Bank, and the UN are the largest multilateral donors, while Japan, the United States, and Germany provide the lion's share of traditional bilateral assistance. In Mongolia, USAID places a high premium on promoting cooperation among other donors and among implementing partners.

Coordination between the donors is excellent in Mongolia. The close relationship between USAID, the World Bank, the IMF, the ADB, the United Nations, Germany, and Japan provides an outstanding example of effective donor coordination. Donors meet monthly under the auspices of the UNDP, and ad hoc meetings to discuss issues of urgent importance are convened as often as needed. In early 2004, the GOM began to create a more formal structure for donor coordination including the establishment of thematic working groups. This effort continues at a slow pace.

In FY 2005, the Mongolian Government allowed its IMF Program to lapse. Unwilling to take corrective action on IMF recommendations about the Central Bank, budget deficit, and debt load, the Government has not re-engaged with the IMF, and no new program has been discussed. The next Consultative Group (CG) - the last one was in November 2003 - has been postponed indefinitely. In late FY 2005, donors convened under the auspices of the World Bank to discuss how best to focus and coordinate assistance to Mongolia given problems with the IMF and the inability to definitively schedule a CG meeting. This resulted in scheduling a technical meeting in late February 2006 that will serve as a forum for improved dialogue between donors and the Government of Mongolia and improved donor coordination.

CHALLENGES: Mongolia's vast territory, small population, land-locked status, and distance from most world markets represent its greatest development challenges. Air travel to Mongolia is costly, domestic air links are sporadic, and the principal domestic airline is in serious financial trouble. A rail line connecting China and Russia runs through the middle of the country, and a shorter spur connects Russia with the eastern Mongolian town of Choibalsan. But there are less than 1,000 miles of all-weather road in the country, and travel in Mongolia usually involves long and arduous journeys on dirt tracks. The fact that most international trade must transit inefficient and expensive rail lines and ports in China and Russia adds to the cost of shipping and trade.

The size and structure of Mongolia's economy pose a formidable challenge. Adverse weather conditions--summer drought, especially in the Gobi Desert, and extreme winter conditions everywhere--make herding a risky occupation for the 42 percent of Mongolians still employed in the agricultural sector. At the

same time, while world copper and gold prices are currently high and Mongolia enjoys a geographical advantage by virtue of its proximity to the rapidly growing markets of China, it is inevitable that the country's emerging mining sector will ultimately be affected by the cyclical "boom or bust" nature of world mineral markets.

Lack of capacity in both government and the private sector is a critical issue. This is partly because many of the concepts and basic building blocks of a market economy are imperfectly understood. To a certain extent, "success" has been measured more by the passage of new laws and regulations rather than by their effective implementation. Poverty remains stubbornly high at around 36 percent, and continued emigration from rural areas to Ulaanbaatar reflects the fact that economic activity and investment are centered in the capital. Questions of accountability and corruption also continue to be raised. A concerted and unwavering commitment to reform will be required from the Mongolian government if economic growth, led by the private sector, is to achieve desired levels. To date, although the general picture is a relatively optimistic one, GOM commitment has been mixed. For example, while support for a new, comprehensive tax reform package developed with USAID assistance has been strong, proposed mining legislation could have a dramatic, adverse impact on private sector mining that has largely fueled recent increases in GDP. Similarly, the GOM has yet to demonstrate a strong commitment to introduce concessions laws affecting public utilities, to enact new laws to increase investor confidence in the power sector, or to allow market forces to set the price of energy. USAID, along with the rest of the U.S. Embassy Country Team, will continue to press for a strong GOM commitment to enact and implement needed reforms.

KEY ACHIEVEMENTS: USAID achieved important results in 2005, especially in economic policy reform, energy sector reform, business promotion, judicial reform, political party strengthening, and parliamentary reform. The level of mutual reinforcement within and between Strategic Objectives is exceptional, with national level policy reforms directly complementing the work of USAID's on-the-ground business promotion projects, and the judicial work strengthening our work on the investment climate. Significant achievements in 2005 are detailed below.

PRIVATE SECTOR-LED ECONOMIC GROWTH: USAID seeks to accelerate and strengthen sustainable, private sector-led economic growth by improving the enabling environment; making Mongolian industries and sectors more internationally competitive; and expanding economic opportunities for marginalized Mongolians. This was the second year for the Economic Policy Reform and Competitiveness Project (EPRC), which brought under a single contract USAID's macroeconomic policy reform, industry competitiveness, privatization, and energy sector reform work. The governing hiatus after the June 2004 parliamentary elections was resolved at the start of FY 2005 with the establishment of a bipartisan power-sharing arrangement, which created an opportunity to effect major legislative changes that neither political faction could pass on their own. EPRC became deeply involved in development of a bipartisan package of legislative proposals for tax reform, work which could improve Mongolia's investment climate, support domestic production and exports, reduce the fiscal burden on labor, and create new jobs in the private sector. This work, focused by the results of an external evaluation just completed, will continue into FY 2006 and a major tax package--including value added tax, personal income tax, and corporate income tax legislation--is expected to go before Parliament early in 2006.

EPRC had many other successes in 2005. In collaboration with the ADB, it did major analytical work leading to the formation of a private equity fund which, as planned, the ADB will support as the anchor institutional investor. It also made Mongolian cashmere more internationally competitive through direct international marketing of cashmere retailers; began design of a private sector-led housing finance corporation and credit information bureau; improved transparency by initiating public on-line "super chats" with key government officials through the Open Government Website supported by the project; and created a core system of tourist information centers which has since been extended overseas to Tokyo and London with GOM resources. In the energy sector, EPRC institutionalized a system of internationally accepted accounting practices that, for the first time, accurately show the very difficult financial situation that the sector is in, and it worked with the Energy Regulatory Authority (ERA) on public hearing and dispute resolution procedures, market structure and rules, and several key pieces of draft legislation.

USAID's efforts to expand economic opportunities for marginalized Mongolians focus on two areas--the Gobi Desert, which covers the southern third of the country, and the peri-urban areas around the country's four largest cities. In both cases, USAID partners expanded economic opportunities by creating and strengthening businesses. In the countryside, the Gobi Initiative used the widely emulated human and institutional infrastructure established over the past few years to create or strengthen 242 rural businesses. It also increased the availability of and access to business information by over 485,000 rural Mongolians through publication of Rural Business News and a series of innovative radio programs. The GER Initiative, focused on the poor communities surrounding Mongolia's largest urban centers, created or strengthened 506 businesses in 2005, and helped over 1600 people find employment. Both Gobi and GER have aggressively worked to bring clients and local banks together through innovative methods of reducing bank collateral risk and administrative load. An external evaluation in FY 2005 gave the two projects very high marks. In both of them, women represent a significant proportion of the beneficiaries. In the Gobi II, although the herder population is predominately male, non-herder businesses are predominantly women-owned. In the GER project, the majority of entrepreneurs receiving business services, as well as the majority of job-seekers placed in permanent employment, are female.

MORE EFFECTIVE AND ACCOUNTABLE GOVERNANCE: USAID helps make Mongolia's government more effective and accountable by working with the judiciary to strengthen the courts and implement a comprehensive set of legal reforms; and with Parliament and the electoral commission to make political processes more competitive, effective, and transparent.

Judicial reform is one of the most challenging elements of any good governance initiative. In 2005, USAID's partner in judicial reform, the National Center for State Courts (NCSC), significantly improved court administration; strengthened the National Legal Center (NLC), which provides continuing education for judges (60 percent of whom are women) and other legal sector personnel; strengthened the Special Investigations Unit that reports to the Prosecutor General; improved the public's understanding of their rights through innovative TV programming and information posters in all courts; continued to improve access to court information through public access terminals and a new national website; and dramatically improved the national lawyer qualification ("Bar") exam.

The USAID objective of promoting more competitive, effective, and transparent political processes is implemented through a partnership with the International Republican Institute (IRI). After the dramatic successes of 2004, when political party work led directly to proportional representation in parliament, USAID focused party and electoral reform work on the presidential election of May 2005 and parliamentary by-election in August 2005. USAID trained more than 1000 poll watchers and produced tens of thousands of poll watcher training manuals and both elections accurately "represented the will of the people." The program focused its 2005 parliamentary work on promoting passage of the ethics legislation submitted to Parliament in August 2005 and implementation of the Parliamentary Procedures Law enacted in 2004 that could auger a major redistribution of power from the central Secretariat's Office to the parliamentary committees. IRI organizing the Forum on Women's Partnership in Politics and Governance, resulting in a new stipulation in Mongolia's draft Election Law (currently being debated in Parliament) that requires that 30 percent of each party's direct candidates must be comprised of women. Also in FY 2005, USAID funded an assessment of corruption in Mongolia that was extremely well received by the GOM, donors, and NGO community, and which formed the basis for designing USAID's new three year anti-corruption project.

The overall USAID program in Mongolia is supported by both regional and central resources. A new project was initiated in FY 2005 with funding from the Regional Development Mission/Asia to address the potential threat posed by HIV/AIDS. With central funds, USAID began the design of a Mongolian component of the Last Mile Initiative, which will support pilot efforts to extend the benefits of information and communications technology to the farthest reaches of the country.

More information on USAID/Mongolia's program is available at: <http://www.usaid.gov/mn/>

FY 2006 Program**SO: 438-001 Accelerate and Broaden Sustainable, Private Sector Led Economic Growth****Improve Economic Policy and the Business Environment**

Improve Economic Policy and the Business Environment (\$3,025,000 ESF). Building on the highly cooperative working relationships developed with the GOM, USAID is continuing to pursue critical economic policy reforms in 2006. A comprehensive, bipartisan "competitiveness-based" tax reform package developed with USAID assistance is being submitted to Parliament in FY 2006. This package will have far-reaching effects on the Mongolian economy, including a reduction in private sector investment costs that should increase foreign direct investment. USAID is assisting with key steps in the consideration of this package, including the conduct of workshops for the Parliamentary Tax Working Group. USAID is continuing to emphasize the important issue of power sector reform and eventual privatization as a crucial step toward improving the overall environment for growth. In 2006, a small cabinet-level unit to advise all Ministries on important policy options is being established and supported with technical advice. USAID is also helping the private banking sector establish a Housing Finance Corporation, with appropriate mortgage and other debt instruments, and is assisting with the privatization of the Credit Information Bureau. Principal Implementers: Chemonics in partnership with The Asia Foundation (TAF) and The Services Group.

Improve Private Sector Competitiveness

Improve Private Sector Competitiveness (\$1,700,000 ESF). Direct assistance to marginalized Mongolians in the Gobi region (the Gobi Initiative Phase II) and in peri-urban areas (the Growing Entrepreneurship Rapidly (GER) initiative) is providing business development services (e.g., product development, marketing), as well as access to financing and business information. While the emphasis will remain on strengthening individual businesses, other activities include the development of new business associations to support private entrepreneurs. Business outreach is taking place through radio, television, and newspapers, including the popular TV series, the "Endless Labyrinth." USAID is also working to expand opportunities for small, poorer businesses to sell products to larger companies. As results from last year demonstrate, connecting small businesses with larger companies offers considerable potential for new job creation and can be a source of increased sales. Another focus is on the development of private-public partnerships and the facilitation of more interaction between small businesses and local governments. The Economic Policy Reform and Competitiveness Project (EPRC) is supporting the implementation of a new, private sector equity fund. This fund has the potential to dramatically increase the availability of investment capital in the country. EPRC is continuing its important work to help identify and exploit markets for Mongolian products and services such as cashmere, pet food, meat products, blueberries, and tourism. Principal Implementers: Mercy Corps International (MCI), the Cooperative Housing Foundation (CHF), and Chemonics.

Increase Trade and Investment

Increase Trade and Investment (\$300,000 ESF). The focus of this component of the EPRC project in FY 2006 is establishing and supporting a new trade negotiation, administration, and compliance unit within the Ministry of Industry and Trade. This support builds upon previous technical assistance (e.g., work on Mongolia's inclusion in the European Union's Generalized System of Preferences) in institutionalizing the GOM's capacity to analyze trade issues and effectively negotiate agreements. With the conclusion of this effort, USAID is ending its assistance in trade and investment and will not fund further activities under this program component beyond FY 2006. Principal Implementers: Chemonics and The Services Group.

FY 2007 Program**SO: 438-001 Accelerate and Broaden Sustainable, Private Sector Led Economic Growth****Improve Economic Policy and the Business Environment**

Improve Economic Policy and the Business Environment (\$2,600,000 ESF). In FY 2007, USAID will continue to work with the GOM and the private sector to strengthen economic performance, especially the policy environment. The FY 2007 program should see more emphasis on efforts to increase sales, employment, and exports. Important policy reform work will continue, particularly the difficult task of following approved policies through implementation, and USAID will work with revenue departments and private companies to help them to fully understand and implement new tax regimes. By 2007, USAID plans to be more involved in helping prepare individual energy companies for privatization and in the elimination of specific regulatory bottlenecks to private sector growth. Principal Implementers: Chemonics in partnership with TAF and The Services Group.

Improve Private Sector Competitiveness

Improve Private Sector Competitiveness (\$3,000,000 ESF). The Gobi II and GER projects will continue to provide business development services to herder groups and other businesses. Support to associations in the GER areas will be emphasized and possible ways to "privatize" some services will be explored. Information, product improvement, credit, marketing, and other business services will continue for rural and peri-urban businesses, but the focus may shift to institutionalizing some services (e.g. financial). In urban areas, USAID will continue efforts to link poorer businesses with larger companies to increase sales and generate jobs on a continuing basis. We will also explore the possibility of spinning-off certain components of the GER Initiative to private sector entities which have expressed an interest in "buying" them. EPRC will continue to support improvements in the competitiveness of Mongolian firms, including the creation of business groups with the potential to increase exports. Principal Implementers: MCI, CHF, and Chemonics.

FY 2006 Program

SO: 438-002 More Effective and Accountable Governance

Promote And Support Anti-Corruption Reforms

Promote and Support Anti-Corruption Reforms (\$200,000 ESF). In FY 2006, USAID is implementing the Mongolian Anti-Corruption Support Project. Interventions are mobilizing civil society groups to advocate for and monitor the implementation of more comprehensive and effective anti-corruption laws. The initial focus is on conflict of interest legislation, complemented by public awareness campaigns and training for the media in investigative journalism. In addition, the Judicial Reform Project (JRP) is continuing its support to the Special Investigative Unit of the Prosecutor's office. Principal Implementers: The Asia Foundation (TAF) and the National Center for State Courts (NCSC).

Promote and Support Credible Elections Processes

Promote and Support Credible Elections Processes (\$100,000 ESF). USAID is assisting the General Election Commission in implementing the new election law and in developing regulations on campaign finance monitoring. Assistance is continuing to support electoral reform to expand participation, particularly for women. Principal Implementer: International Republican Institute (IRI).

Strengthen the Justice Sector

Strengthen the Justice Sector (\$2,000,000 ESF). In FY 2006, USAID is continuing support to improve court administration and case management. Training programs that previously focused on judges and court personnel are shifting to prosecutors and advocates, ensuring that all justice sector personnel are knowledgeable about new criminal and civil codes. Support to the National Legal Center, established with assistance from USAID, continues. The Center is now capable of conducting training without donor funding, but its ability to fund recurrent budget costs requires attention in FY 2006. Previously successful

efforts to improve case management are being extended to prosecutors' offices in rural courts. Customer service is being addressed through improved procedures in courtrooms that are helping people to understand and exercise their judicial rights. Public access terminals are being monitored and improved to ensure that they are being effectively used, and a new Internet website is being completed that provides case information to justice sector personnel, as well as the general public. USAID is supporting the development of an independent advocates association and is working with the General Counsel of Courts to improve budgeting and financial management. Principal Implementers: NCSC with sub grants to TAF and Pact.

Strengthen the Legislative Function/Legal Framework

Strengthen the Legislative Function/Legal Framework (\$100,000 ESF). Activities in FY 2006 for the new Mongolian Electoral and Parliamentary Support program focus on the implementation of the Parliamentary Procedures Law and enactment of a new Ethics Law for members of Parliament. This effort includes continued support to implement new ethics rules and procedures. Support is being provided to strengthen the participation of women, and work is beginning to help establish a capacity within the Parliament to carry out policy research and analysis. Principal Implementer: IRI.

FY 2007 Program

SO: 438-002 More Effective and Accountable Governance

Promote And Support Anti-Corruption Reforms

Promote and Support Anti-Corruption Reforms (\$400,000 ESF). In FY 2007, the JRP will expand its programs to increase transparency in the courts to encompass new public education activities and work will continue to strengthen the Special Investigative Unit and Judicial Disciplinary Committee. Principal Implementer: NCSC.

Strengthen the Justice Sector

Strengthen the Justice Sector (\$1,500,000 ESF). In FY 2007, the Judicial Reform Project will focus on nationwide implementation of new, improved court procedures, as well as "universal" availability of case information through, among other means, the creative use of information and communications technology. The advocates association will be further strengthened and training will be extended to local level jurisdictions throughout the country. Surveys will be conducted to assess the public's view of the fairness and effectiveness of the judiciary. Principal Implementer: NCSC.

Results Framework

438-001 Accelerate and Broaden Sustainable, Private Sector Led Economic Growth

Program Title: Private Sector-Led Economic Growth

- IR1.1:** Improved Enabling Environment for Private Sector Growth
- IR1.2:** More Competitive Industries and Sectors
- IR1.3:** Expanded Economic Opportunity for Marginalized Mongolians

438-002 More Effective and Accountable Governance

Program Title: More Effective and Accountable Governance

- IR2.1:** Comprehensive Legal Reforms Implemented
- IR2.2:** Political Processes More Competitive, Effective and Transparent